

Audit

Report



PILOT PROGRAM ON SALES OF MANUFACTURED ARTICLES
AND SERVICES OF ARMY INDUSTRIAL FACILITIES

Report No. 99-121

April 2, 1999

Office of the Inspector General
Department of Defense

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Acronym

IOC Industrial Operations Command



**INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884**

April 2, 1999

**MEMORANDUM FOR UNDER SECRETARY OF DEFENSE FOR ACQUISITION
AND TECHNOLOGY
AUDITOR GENERAL, DEPARTMENT OF THE ARMY**

SUBJECT Audit Report on the Pilot Program on Sales of Manufactured Articles and Services of Army Industrial Facilities (Report No 99-121)

We are providing this audit report for review and comment. We conducted the audit in response to section 141 of Public Law 105-85, "National Defense Authorization Act for FY 1998". This is the first of two reports on the subject pilot program. We considered management comments on a draft of this report when preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. The Under Secretary of Defense for Acquisition and Technology and the Army comments were not responsive. For this report, we readdressed Recommendation 2. to the Under Secretary. Accordingly, we request that the Under Secretary of Defense for Acquisition and Technology provide additional comments on Recommendations 1. and 2., by May 3, 1999.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Garold E. Stephenson at (703) 604-9332 (DSN 664-9332) (gstephenson@dodig.osd.mil) or Mr. Eugene E. Kissner at (703) 604-9323 (DSN 664-9323) (ekissner@dodig.osd.mil). See Appendix C for the report distribution. The audit team members are listed inside the back cover.

David K. Steensma

David K. Steensma
Deputy Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 99-121
(Project No 9CH-5022)

April 2, 1999

Pilot Program on Sales of Manufactured Articles and Services of Army Industrial Facilities

Executive Summary

Introduction. We are issuing this report because the three Army industrial facilities participating in the pilot program have not yet had sufficient experience under the program to permit an evaluation of the program, and time is limited for DoD to request that Congress extend the program. This report discusses the status of the Army pilot program to sell manufactured articles and services of three industrial facilities to commercial contractors providing weapon systems to DoD without determining whether the articles and services are available from United States commercial sources. The pilot program is authorized for 2 years by section 141 of Public Law 105-85, "National Defense Authorization Act for FY 1998," November 18, 1997, and provides the opportunity for Rock Island Arsenal, Watervliet Arsenal, and the McAlester Army Ammunition Plant, to increase their workloads by participating in contracts and teaming arrangements with United States manufacturers, assemblers, developers, and other concerns under DoD weapon system programs. The DoD spends about \$33 billion annually to procure major weapon systems.

Objective. The audit objective was to determine the effect of the waiver of 10 U.S.C. 4543(a)(5) on opportunities for United States manufacturers, assemblers, developers, or other concerns; Army industrial facilities; and small businesses to enter into or participate in contracts and teaming arrangements under DoD weapon systems programs.

Results. The pilot program initiative has the potential to produce monetary benefits for modernization and readiness programs but, to date, has resulted in little additional work for the three Army industrial facilities participating in the program. The Army required about 7 months from the time the Authorization Act was signed in November 1997 to implement the pilot program in June 1998. Thus, a 2-year pilot program may only operate for 16 months. Further, publicity of the program may not have reached the appropriate target audience. As of February 1, 1999, Rock Island Arsenal, Watervliet Arsenal, and the McAlester Army Ammunition Plant have obtained six contracts, totaling \$795,086, under the pilot program. Consequently, the Army industrial facilities have not had sufficient experience under the pilot program to fairly assess the program's impact on opportunities for Army industrial facilities, commercial contractors, and small businesses to enter into or participate in contracts or teaming arrangements permitted by the pilot program. See the Finding section for a discussion of the audit results.

Summary of Recommendations. We recommend that the Under Secretary of Defense for Acquisition and Technology direct the Military Services program executive officers and program managers to.

- include information in applicable solicitations on the capabilities and the availability of Rock Island Arsenal, Watervliet Arsenal, and the McAlester Army Ammunition Plant to enter into subcontracts and teaming arrangements under weapons system contracts, and
- obtain from their weapon system developers, manufacturers, and assemblers a list of manufactured articles and services that could be subcontracted to the three Army industrial facilities, and a commitment to solicit bids from the appropriate industrial facility when subcontracting for the articles or services.

We also recommend that the Under Secretary of Defense for Acquisition and Technology initiate action to request that Congress extend the Army pilot program and the waiver of the requirement in 10 U S C 4543(a)(5).

Management Comments. The Acting Deputy Under Secretary of Defense (Industrial Affairs) and the Deputy Assistant Secretary of the Army (Procurement) provided comments on the draft report. The Deputy Under Secretary nonconcurred with the recommendation to issue guidance to the Military Services, stating that the recommended guidance is not necessary, and that such guidance could be construed as an endorsement of the desirability of encouraging public industrial facilities to compete with private enterprises, which is contrary to Federal policy.

The Deputy Assistant Secretary nonconcurred with the Army requesting an extension of the pilot program. The Deputy Assistant Secretary stated that "the program appears to be contrary to the objectives and goals of the Government Performance and Results Act of 1993, as implemented by the DoD-wide goal referred to in the report." The Deputy Assistant Secretary also stated that "this will tend to fill up these facilities with commercial work and make it harder to justify reducing them." The Deputy Assistant Secretary further stated that an 18-month review period would be adequate for the Army to assess the merits of the pilot program. A discussion of management comments is in the Finding section of the report and the complete text is in the Management Comments section.

Audit Response. The comments were nonresponsive. We maintain that the Finding is valid and that the recommended actions are needed. Competition between the public and private sectors is not new. The Defense Reform Initiative, which was announced in November 1997, emphasizes competition between the public and private sectors as a way to lower costs and improve service. The Defense Reform Initiative states that DoD will pursue public-private competition to the extent allowed by law. The recommendations were made with the intent of assisting the Department better implement congressional direction. For the final report, we redirected the recommendation on requesting Congress to extend the pilot program to the Under Secretary of Defense for Acquisition and Technology because that office can more directly initiate requests for legislation. We request that the Under Secretary of Defense for Acquisition and Technology reconsider his position and provide additional comments on the final report by May 3, 1999.

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Background

National Defense Authorization Act for FY 1998. We conducted the audit in response to a tasking in Public Law 105-85, "National Defense Authorization Act for FY 1998," (the Authorization Act). Section 141 of the Authorization Act requires the Inspector General, DoD, to review the Army pilot program to sell manufactured articles and services of Army industrial facilities to persons outside DoD without determining whether the articles and services are available from United States commercial sources as required by Title 10, United States Code (U.S.C.), section 4543(a)(5). The waiver of 10 U.S.C. 4543(a)(5) applies to the sale of articles to be incorporated into weapon systems being procured by DoD, and services to be used in the manufacture of weapon systems for which solicitation offers are issued during FYs 1998 and 1999. Before the waiver, the Army was allowed to sell manufactured articles or services to persons outside the DoD only when the Secretary of the Army determined that the articles and services were not available from commercial sources located in the United States.

Congressional Concerns. The Senate Committee on Armed Services expressed concern in their Authorization Act report that with the end of the Cold War and the beginning of reduced defense budgets, DoD military industrial facilities were operating inefficiently because work was not available. The committee believed these facilities should be allowed to provide commercial contractors with articles and services for inclusion in weapon systems that would ultimately be procured by the DoD. The committee believed that using this excess capacity would reduce facility operating costs, provide private industry with quality service, and maintain a critical work force. Therefore, the committee recommended a provision that would authorize Army industrial facilities to sell articles and services to commercial entities that would ultimately be incorporated into weapon systems procured by DoD. According to Army officials, in December 1998, 76 percent of Rock Island Arsenal industrial capacity and 83 percent of Watervliet Arsenal industrial capacity was unused compared to less than 20 percent of unused capacity in 1988. The unused industrial capacity at McAlester Army Ammunition Plant was 86 percent at the end of 1998.

Guidance Addressing Sales of Articles and Services Outside DoD

Pilot Program Requirement Section 141 of the Authorization Act requires the Army to carry out a pilot program to test the efficacy and appropriateness of selling manufactured articles and services of Army industrial facilities under 10 U.S.C. 4543 without regard to the availability of the articles and services from United States commercial sources. In carrying out the pilot program, the Authorization Act permits the Secretary of the Army to sell articles manufactured at, and services provided by, not more than three Army industrial facilities.

Temporary Waiver of Requirement to Determine Availability from Domestic Source. The Authorization Act waives the requirement in 10 U.S.C. 4543(a)(5) for the Army to determine whether an article or service is available from a commercial source located in the United States for the following sales for which solicitation offers are issued during FYs 1998 and 1999 for:

- articles to be incorporated into a weapon system being procured by DoD, and
- services to be used in the manufacture of a weapon system being procured by DoD.

Pilot Program Review Requirement. The Authorization Act requires the Inspector General, DoD, to review the pilot program and report the results of the review to Congress by July 1, 1999. The report should assess the extent to which the temporary waiver of 10 U.S.C. 4543(a)(5)

- enhances the opportunity for United States manufacturers, assemblers, developers, and other concerns to enter into or participate in contracts and teaming arrangements with Army industrial facilities under DoD weapon system programs,
- enhances the opportunity for Army industrial facilities to enter into or participate in contracts and teaming arrangements with United States manufacturers, assemblers, developers, and other concerns under DoD weapon system programs, or
- affects the ability of small businesses to compete for the sale of manufactured articles or services in the United States in competitions to enter into or participate in contracts and teaming arrangements under DoD weapon system programs

The report may also include examples and recommendations that the Inspector General considers appropriate regarding continuation or modification of the policy as set forth in 10 U.S.C. 4543(a)(5)

Objective

The audit objective was to determine the effect of the waiver of 10 U.S.C. 4543(a)(5) on opportunities for United States manufacturers, assemblers, developers, or other concerns; Army industrial facilities; and small businesses to enter into or participate in contracts and teaming arrangements under DoD weapon system programs. See Appendix A for a discussion of the audit scope and methodology.

Pilot Program Implementation

The pilot program did not generate significant additional work for the three participating Army industrial facilities. Significant work was not generated because the Army took almost 7 months to implement the pilot program. Additionally, pilot program publicity may not have reached the appropriate target audience. The three Army industrial facilities participating in the pilot program have obtained only six contracts, totaling \$795,086, under the pilot program. As a result, the three participating Army industrial facilities have not had sufficient experience under the pilot program to fairly assess the program's impact on opportunities for Army industrial facilities, United States commercial contractors, and United States small businesses to enter into or participate in contracts or teaming arrangements under DoD weapon system programs.

Pilot Program Responsibility

The Office of the Assistant Secretary of the Army (Research, Development, and Acquisition) has primary responsibility for the Army pilot program. The program is managed by the Army Industrial Operations Command (IOC), a major subordinate command of the Army Materiel Command. The IOC manages and operates the Army organic industrial base of arsenals, plants, and depots responsible for the manufacture, maintenance, and storage of assigned weapons and ammunition.

Army Implementation of the Pilot Program

Implementing Guidance. The Authorization Act was enacted on November 18, 1997. On March 23, 1998, almost 4 months later, the Acting Secretary of the Army tasked the Assistant Secretary of the Army (Research, Development, and Acquisition) to issue implementing guidance and the Army Materiel Command to implement the program. The Acting Secretary also approved an IOC recommendation that Rock Island Arsenal, Watervliet Arsenal, and the McAlester Army Ammunition Plant participate in the pilot program.

On April 29, 1998, the Acting Assistant Secretary of the Army (Research, Development, and Acquisition) issued three guidelines for the pilot program to the Army Materiel Command.

- Items and services offered for sale to any single bidder on a Government contract should be equally available to all offerors
- Because the Army is moving into an area where these facilities will be competing with private sector facilities, sales under this authority shall

include certain indirect costs in addition to the variable costs, including any applicable depreciation and any capital improvement costs specifically associated with the projects

- Conduct market research for each product or service proposed to be sold and use this data to assess the impact on private sector sources

Army Materiel Command and IOC Implementation. On May 6, 1998, the Army Materiel Command tasked the IOC to provide an implementation plan by May 22, 1998. On June 1, 1998, the IOC stated that the Army industrial facilities already complied with the first two guidelines when entering into sales agreements under 10 U.S.C. 4543. To comply with the third guideline, the IOC tasked the industrial facilities to retain summary-level market research data for initiatives falling under the pilot program. The IOC took the following additional actions to implement the pilot program.

- Published a notice in the June 1, 1998, Commerce Business Daily (public notification media by which U.S. Government agencies identify proposed contract actions and contract awards) that provided IOC points of contact for information on the pilot program. On June 4, 1998, a correction was made to the original notice and no additional notices were published.
- Issued a memorandum on June 9, 1998, to Army program executive officers, program managers, and product managers, advising them of the pilot program and encouraging them to include information in applicable solicitations announcing the availability of the three industrial facilities for subcontracting under 10 U.S.C. 4543. Army officials could not identify any solicitations that announced the availability of the Army industrial facilities to enter into subcontracts or teaming arrangements under DoD weapon system contracts. We believe that to obtain broader implementation of the Army pilot program, a similar memorandum should have been sent to Navy, Air Force, and Marine Corps program executive officers and program managers.
- Notified Rock Island Arsenal, Watervliet Arsenal, and the McAlester Army Ammunition Plant, to initiate contact with appropriate contractors concerning the availability of the industrial facilities to enter into subcontract or teaming arrangements under the pilot program
- Developed and published a brochure on the pilot program that identified the capabilities of the three participating industrial facilities and a point of contact at each facility. According to Army IOC officials, as of January 1999, more than 1,000 brochures were distributed. The first group to receive the brochure was the 70 program executive officers, program managers, and product managers included in the distribution of the IOC June 9, 1998, memorandum that explained the pilot program. The other 900 plus brochures were passed out at trade shows
- Briefed the pilot program to attendees at the September 10, 1998, meeting of the Joint Depot Maintenance Advisory Group, Wright-

Patterson Air Force Base. Attendees at the meeting included representatives from the Military Services.

Rock Island Arsenal, Watervliet Arsenal, and McAlester Army Ammunition Plant Implementation. The business development offices at Rock Island Arsenal, Watervliet Arsenal, and the McAlester Army Ammunition Plant are marketing their participation in the pilot program through on-going contacts with current and potential contractors. Rock Island Arsenal also advertises its participation in the pilot program on its internet website. Additionally, Rock Island Arsenal advertised the pilot program at trade shows in several cities, including Washington, District of Columbia; Philadelphia, Pennsylvania, Cleveland, Ohio; and San Francisco, California.

Results of Pilot Program Implementation

The pilot program did not generate significant additional work for the three participating Army industrial facilities. Significant work was not generated because the pilot program had been formally active for only about 8 months (June 1998 - January 1999) because Army implementing guidance was not issued until June 1998. Additionally, the Navy, the Air Force, and the Marine Corps program executive officers and program managers have not been formally made aware of the pilot program and the capabilities of the participating Army industrial facilities. Consequently, the three participating Army industrial facilities have not had sufficient experience under the program to allow the Inspector General, DoD, to assess the impact of the program on opportunities for Army industrial facilities, commercial contractors, and small businesses to enter into or participate in contracts and teaming arrangements under DoD weapon system programs. Because of the delayed implementation, it is unlikely that sufficient additional experience will be gained under the pilot program before it expires at the end of FY 1999. As of February 1, 1999, six contracts totaling \$795,086 were obtained under the program, even though the Defense Contract Action Data System shows that during June through September 1998, DoD organizations awarded more than 10,000 contract actions, valued at \$3.9 billion, to commercial contractors for DoD weapon systems. See Appendix B for a summary of contracts obtained under the pilot program.

Conclusion

The pilot program has the potential to produce needed monetary benefits for modernization and readiness programs and should be promptly given high-level emphasis to ensure broad implementation. Because the Army industrial facilities can perform work related to any weapon system being procured by DoD, the Under Secretary of Defense for Acquisition and Technology should issue guidance requiring that the Military Services program executive officers and program

managers: include information in applicable solicitations on the capabilities and availability of Rock Island Arsenal, Watervliet Arsenal, and the McAlester Army Ammunition Plant to enter into subcontracts and teaming arrangements under the weapon system contracts, and obtain from each of their weapon system developers, manufacturers, and assemblers a list of manufactured articles and services that could be subcontracted to the three Army industrial facilities and a commitment to solicit bids from the appropriate industrial facility when subcontracting for the articles or services. Because of delayed implementation and limited program publicity, sufficient experience has not been achieved to permit a fair assessment of the program. We believe the Under Secretary of Defense for Acquisition and Technology should request that Congress extend the pilot program to provide an opportunity for the three participating Army industrial facilities to gain additional experience with the program

Management Comments on the Finding and Audit Response

Under Secretary of Defense for Acquisition and Technology Comments on Pilot Program Implementation. The Acting Deputy Under Secretary of Defense (Industrial Affairs) did not concur with the audit conclusion that the pilot program has the potential to produce monetary benefits for modernization and readiness programs and should be given high-level emphasis to ensure broad implementation. The Deputy Under Secretary stated that the Inspector General, DoD, did not present information or analyses to support the conclusion that public facility competition with private enterprises truly results in a monetary benefit to the DoD.

The Deputy Under Secretary also stated that the audit report would be more valuable if it addressed the following issues.

- Has the corporate Army formally determined that it must retain all of its organic industrial facilities? Should some/all be closed or downsized?
- Are the facilities and relevant industrial capabilities that are proposed for the pilot program among those that the Army needs to retain?
- To what extent will this pilot program influence DoD/Army decisions associated with reducing excess organic infrastructure?
- When organic industrial facilities bid for work, do their bids reflect all relevant costs? (Is the competition between public and private enterprises fair?)
- To what extent do successful organic industrial facility bids negatively impact the viability of privately owned competitors?

Audit Response. The Deputy Under Secretary comments were not responsive. We do not understand the nonconcurrency with the statement that the pilot program has the potential to produce monetary benefits. The goal of the pilot program is to emphasize competition between the public and private sectors as a

way to lower costs and improve service. The pilot program provides the Army industrial facilities the opportunity to compete for work as subcontractors, and to integrate the manufacturing capabilities in the public and private sectors. The comments are inconsistent with the competition strategy of the Defense Reform Initiative, which is to pursue public-private competitions to the extent allowed by law.

The Deputy Under Secretary should address the issues about use of the industrial facilities to the Army. The Army is responsible for the operation of arsenals and with implementing the pilot program.

Recommendations, Management Comments, and Audit Response

1. We recommend that the Under Secretary of Defense for Acquisition and Technology issue guidance that directs the Military Services program executive officers and program managers to:

a. Include information in applicable solicitations on the capabilities and availability of Rock Island Arsenal, Watervliet Arsenal, and the McAlester Army Ammunition Plant to enter into subcontracts and teaming arrangements under the weapon system contracts.

b. Obtain from each of their weapon system developers, manufacturers, and assemblers a list of manufactured articles and services that could be subcontracted to the three Army industrial facilities, and a commitment to solicit bids from the appropriate industrial facility when subcontracting for the articles or services.

Under Secretary of Defense for Acquisition and Technology Comments. The Acting Deputy Under Secretary of Defense (Industrial Affairs) nonconcurred, stating that the recommended guidance is not necessary or desirable. He stated that from FYs 1996 through 1998 direct sales between 13 Government-owned, Government-operated facilities and private industry resulted in about \$31.2 million of partnered workload. Additionally, during the same period, program managers directly workloaded \$430 million of shared work with industry into the 13 Government-owned, Government-operated facilities. This work, coupled with the pilot program experience should be sufficient for the Inspector General, DoD, to address the issues posed by Congress. The Deputy Under Secretary further stated that issuance of the recommended guidance could be construed as an endorsement of the desirability of encouraging public industrial facilities to compete with private enterprises, which is contrary to Federal policy.

Audit Response. The Deputy Under Secretary comments were nonresponsive. We believe that issuing the recommended guidance is necessary to facilitate the competition authorized by the law. We do not agree that direct sales work and directly workloaded shared work at 13 industrial facilities can be coupled with

pilot program work to evaluate the pilot program at the 3 facilities. The intent of the recommendation is to publicize the pilot program and increase opportunities for competition under the program. We request that the Office of the Under Secretary of Defense for Acquisition and Technology reconsider its position and provide additional comments on the recommendation in response to the final report.

2. We recommend that the Under Secretary of Defense for Acquisition and Technology initiate action to request that Congress extend the Army pilot program and the waiver of the requirement in 10 U.S.C. 4543(a)(5).

Army Comments. The Deputy Assistant Secretary of the Army (Procurement) nonconcurred, stating that the pilot program appears to be directly contrary to the objectives and goals of the Government Performance and Results Act of 1993 as implemented by the DoD-wide goal referred to in the report. The Deputy Assistant Secretary stated that "this will tend to fill up these facilities with commercial work and make it harder to justify reducing them." The Deputy Assistant Secretary also stated that unless 10 U.S.C. 4543 is withdrawn, the Army will review the results of the pilot program after September 30, 1999, and make recommendations at that time. Further, an 18-month period would be adequate to assess the merits of the pilot program.

Audit Response. We do not agree that the pilot program is contrary to the objectives and goals of the Government Performance and Results Act. The overall objective of the Act is to provide for the establishment of strategic planning and performance measurement in the Federal Government. The specific DoD-wide goal referred to in the report is to reduce costs while maintaining required military capabilities across all DoD mission areas (see Appendix A). The pilot program is in consonance with the Government Performance and Results Act because it provides an opportunity for the industrial facilities to increase their workloads, reduce unused capacity, reduce facility operating costs, and maintain a critical work force. Neither the Government Performance and Results Act nor the specific DoD-wide goal requires that the Army limit work entering the industrial facilities so that it can justify reducing the facilities. The Authorization Act requires that the Inspector General, DoD, review the pilot program and report the results to Congress by July 1, 1999. We made the recommendation because the Army delayed implementation of the pilot program and provided limited program publicity thus, the participating industrial facilities will not have sufficient experience under the program to allow the Inspector General, DoD, to fairly assess the impact of the program on the Army industrial facilities, commercial contractors, and small businesses, and report to Congress. For this final report, we readdressed the recommendation to the Under Secretary of Defense for Acquisition and Technology because that office can more directly initiate requests for legislation. We request that the Under Secretary provide comments on the recommendation in his response to the final report.

Appendix A. Audit Process

Scope and Methodology

The audit discussed Army implementation of the pilot program authorized by section 141 of the National Defense Authorization Act for FY 1998. The Authorization Act authorizes the Army to sell, during FYs 1998 and 1999, manufactured articles and services of up to three Army industrial facilities to persons outside the DoD without determining whether the articles and services are available from the United States commercial sources as required by 10 U.S.C. 4543(a)(5). To determine the effect of the pilot program on opportunities for United States manufacturers, assemblers, developers, or other concerns, Army industrial facilities; and small businesses to enter into or participate in contracts and teaming arrangements under DoD weapon system programs, we:

- examined Army guidance on the pilot program,
- reviewed information on the six contracts awarded under the pilot program to Rock Island Arsenal, Watervliet Arsenal, and the McAlester Army Ammunition Plant,
- discussed pilot program implementation with officials at the Office of the Assistant Secretary of the Army (Research, Development, and Acquisition), the Army Materiel Command, the Army IOC, Rock Island Arsenal, Watervliet Arsenal, and the McAlester Army Ammunition Plant;
- reviewed the Army experience and results under the pilot program and discussed the results with officials at the Army Materiel Command, the Army IOC, Rock Island Arsenal, Watervliet Arsenal, and the McAlester Army Ammunition Plant; and
- discussed munitions industry concerns of the Army pilot program with officials from the Munitions Industrial Base Task Force. The Munitions Industrial Base Task Force is a nonprofit organization whose membership includes 15 companies in the munitions business that have a common goal of pursuing adequate funding and policies to sustain a responsive, capable, United States munitions industrial base

DoD-wide Corporate Level Government Performance and Results Act Goals. In response to the Government Performance and Results Act of 1993, the Department of Defense has established 6 DoD-wide corporate level performance

objectives and 14 goals for meeting these objectives. This report pertains to achievement of the following objective and goal.

Objective: Fundamentally reengineer DoD and achieve a 21st century infrastructure **Goal:** Reduce costs while maintaining required military capabilities across all DoD mission areas. **(DoD-6)**

General Accounting Office High Risk Area. The General Accounting Office has identified several high risk areas in the DoD. This report provides coverage of the Defense Weapons Systems Acquisition high risk area.

Use of Computer-Processed Data. We did not use computer-processed data to perform this audit.

Audit Type, Dates, and Standards. We performed this program audit from November 1998 through January 1999 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD.

Contacts During the Audit. We visited or contacted individuals and organizations within the DoD, and selected contractor organizations. Further details are available upon request.

Summary of Prior Coverage

There have been no prior audits of sales of manufactured articles and services by Army industrial facilities without regard to the availability of the articles and services from United States sources during the past 5 years.

Appendix B. Summary of Contracts Obtained Under the Pilot Program

<u>Contracts</u>	<u>Value</u>
<u>McAlester Army Ammunition Plant</u>	
(1) Load, assembly, and pack MK 82, Joint Defense Attack Munitions Prime Contractor: Boeing Aircraft Company Customer: Navy	\$35,704
(2) All up round integration of the Extended Range Guided Munitions Prime Contractor: Raytheon Systems Company Customer: Navy	\$135,904
(3) Demilitarization of 105-mm HEAT Tank Ammo Projectiles Prime Contractor: Primex Technologies Customer: Army	\$64,490
(4) Navy Harpoon System Prime Contractor McDonnell-Douglas Customer: Navy	\$504,825
Subtotal	\$740,923
<u>Rock Island Arsenal</u>	
(1) Machine Top Ring Assembly for the Armored Combat Earthmover Prime Contractor: LOC Performance Products Customer: Army	\$38,885
<u>Watervliet Arsenal</u>	
(1) Machining and inspection of internal thread for Launch Assembly Prime Contractor B&B Devices Customer: Defense Logistics Agency	<u>\$15,278</u>
Total	\$795,086

Appendix C. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition and Technology
Director, Defense Logistics Studies Information Exchange
Under Secretary of Defense (Comptroller)
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Commander, Army Materiel Command
Commander, U S. Army Industrial Operations Command
Commander, McAlester Army Ammunition Plant
Commander, Rock Island Arsenal
Commander, Watervliet Arsenal
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Auditor General, Department of the Navy

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Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Subcommittee on Readiness and Management Support, Committee on Armed Services
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Under Secretary of Defense for Acquisition and Technology Comments



OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON
WASHINGTON DC 20301-3000

March 12, 1999



MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR INSPECTIONS

THROUGH: CONGRESSIONAL ACTIONS AND INTERNAL REPORTS

SUBJECT: Draft of a Proposed Audit Report on a Pilot Program on Sales of Manufactured Articles and Services of Army Industrial Facilities (Project No. 9CH-5022)

Thank you for the opportunity to review the draft audit report on a Pilot Program on Sales of Manufactured Articles and Services of Army Industrial Facilities. The draft audit report focuses on delays in implementing a pilot program authorized by section 141 of the National Defense Authorization Act for FY 1998. The pilot program permits the Army to waive statutory requirements that heretofore permitted the Army to sell manufactured articles and services to persons outside the DoD only after the Secretary of the Army determines that the articles and services are not available from commercial sources located in the US. Fundamentally, the pilot program authorizes Army organic industrial facilities to compete with private concerns for contracts from other private concerns, as long as the article or service eventually will be incorporated into a weapon system.

We do not concur with the draft audit report conclusion that the pilot program initiative has the potential to produce needed monetary benefits for modernization and readiness programs. Nor do we concur with draft audit report recommendations that: (1) USD(A&T) issue guidance to strengthen the pilot program and (2) the Army request an extension of the pilot program to enable the DoDIG to gather more information.

Finally, the final audit report would be more valuable to the Department if it addressed several underlying issues associated with organic industrial infrastructure and public/private competition:

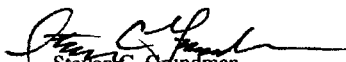
- Has the corporate Army formally determined that it must retain all of its organic industrial facilities? Should some/all be closed or downsized?
- Are the facilities and relevant industrial capabilities that are proposed for the pilot program among those that the Army needs to retain?
- When organic industrial facilities bid for work, do their bids reflect all relevant costs? (Is the competition between public and private enterprises fair?)
- To what extent will this pilot program influence DoD/Army decisions associated with reducing excess organic infrastructure?



1091-1999

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- To what extent do successful organic industrial facility bids negatively impact the viability of privately owned competitors?

Our specific comments are attached.


Steven C. Grundman
Acting Deputy Under Secretary
(Industrial Affairs)

Attachment:

cc:
USD(A&T)
PDUSD(A&T)
ASA(RDA)

Comments on DoDIG Draft of a Proposed Audit Report on a Pilot Program on Sales of
Manufactured Articles and Services of Army Industrial Facilities (Project No. 9CH-5022)

Comments

Page 1. The section titled **Congressional Concerns** includes the statement "Using this excess capacity would reduce facility operating costs, provide private industry with quality service, and maintain a critical work force." The report should make clear that the source of this statement is the Congress. As written, it could appear to some that the statement represents a conclusion of the DoDIG.

Page 6. The **Conclusion** states that this "pilot program has the potential to produce monetary benefits for modernization and readiness programs and should be given high-level emphasis to ensure broad implementation." The DoDIG has not presented information or analyses to support the conclusion that public facility competition with private enterprises truly results in a monetary benefit to DoD.

Specific Recommendations

Recommendation 1. We recommend that the Under Secretary of Defense for Acquisition and Technology issue guidance that directs the Military Services program executive officers and program managers:

- a. Include information in applicable solicitations on the capabilities and availability of Rock Island Arsenal, Watervliet Arsenal, and the McAlester Army Ammunition Plant to enter into subcontracts and teaming arrangements under the weapon system contracts.
- b. Obtain from each of their weapon system developers, manufacturers, and assemblers a list of manufactured articles and services that could be subcontracted to the three Army industrial facilities and a commitment to solicit bids from the appropriate industrial facility when subcontracting for the articles and services.

OUSD(A&T) Comment. OUSD(A&T) does not agree that such guidance is necessary or desirable. As indicated in the comment below, the DoDIG already has available to it sufficient information on which to base a review. Additionally, such USD(A&T) guidance could be construed as an endorsement of the desirability of encouraging public industrial facilities to compete with private enterprises. Such competition is contrary to federal policy.

Recommendation 2. We recommend that the Assistant Secretary of the Army (Research, Development, and Acquisition) request that Congress extend the Army pilot program and the waiver of the requirement in 10 U.S.C. 4543(a)(5).

OUSD(A&T) Comment. OUSD(A&T) does not agree that such an extension is necessary. The Army has significant partnering and teaming experience with industry in addition to the specific "pilot program" experience referenced in the draft report. The Army's Industrial Operations

Command (IOC) has awarded direct sales contracts from FY 1996 through FY 1998 resulting in approximately \$31.2M worth of partnered workload between IOC's 13 Government-owned, Government-operated (GOGO) installations and private industry. Additionally, during the same time frame, program managers have directly workloaded an additional \$430M of shared work with industry into the GOGO installations. This, coupled with the direct "pilot program" experience, should be sufficient for the DoDIG to address the issues posed by the Congress.

Department of the Army Comments



DEPARTMENT OF THE ARMY
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REPLY TO
ATTENTION OF

MAR 01 1999

SARD-PP

MEMORANDUM FOR DOD INSPECTOR GENERAL (AUDITING)

SUBJECT: Project No 9CH-5022—DoD IG Audit Report on Expansion of
Title 10 USC Section 4543

We nonconcur with your recommendation that Army request congressional extension of the program authorized by last year's National Defense Authorization Act. This pilot program now allows Army employees at three specific Army facilities to manufacture and sell commercially available articles and services but will expire at the end of Fiscal Year 1999. We also nonconcur that OUSD(A&T) direct Services to provide lists of components to these facilities and require Services to mandate contractors to obtain bids from these facilities.

This program appears to be directly contrary to the objectives and goals of the Government Performance Results Act as implemented by the DoD-wide goals which you reference in your report. This will tend to fill up these facilities with commercial work and make it harder to justify reducing them.

Unless Section 4543 is otherwise withdrawn, we intend to review the results of the pilot program after September 30, 1999, the end of the trial period, and make final recommendations at that time. We believe that an eighteen-month review period will be adequate to assess the merits of this pilot program.

My point of contact is Mr. Steven R. Linke, who can be reached at (703) 681-7560 or email linkes@sarda.army.mil.

Kenneth J. Oscar
Deputy Assistant Secretary of the Army
(Procurement)

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